

[REDACTED]

[REDACTED] legal secretary). [REDACTED] are both attorneys with expertise in estate planning. You expect to enlarge your board to approximately [REDACTED] people after exemption is granted and operations begin. The owners of [REDACTED] are [REDACTED] and [REDACTED] and [REDACTED]. [REDACTED] was created on [REDACTED], and is not currently engaged in business. It contemplates that it could manage noncharitable trusts in addition to charitable remainder trusts, although it has not commenced any business activity toward creating or administering non-charitable trusts. You state that you contracted with [REDACTED] to assure the confidentiality of donors and trust beneficiaries. The contract with the operations manager is terminable upon [REDACTED]. --you describe the long term as necessary to compensate the operations manager for the business risk involved in providing services for a new venture.

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for charitable or certain other purposes; no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations states that the words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization "operates exclusively" for 501(c)(3) purposes only if it engages primarily in activities that accomplish such purposes. It does not operate exclusively for 501(c)(3) purposes if more than an insubstantial part of its activities does not further such purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes under Section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Rev. Rul. 69-528, 1969-2 C.B. 127, held not exempt under section 501(a) of the Code an organization formed to provide investment services for a fee exclusively to 501(c)(3) organizations. The organization was free from the control of the

participants and had absolute and uncontrolled discretion in investing decisions, distributions of income or principal. The Service reasoned that providing investment services on a regular basis for a fee is a business ordinarily carried on for profit and would constitute unrelated business if conducted by one tax-exempt organization for other tax-exempt organizations (citing section 502).

Rev. Rul. 71-529, 1971-2 C.B. 234, held exempt under section 501(c)(3) of the Code an organization that provided assistance in the management of investment funds of member 501(c)(3) universities for a charge substantially below cost. The organization received capital from the participating exempt organizations and placed it in common funds in the custody of various banks. These common funds were controlled and managed by the organization. The funds were invested upon the advice of independent investment counsel retained by the organization. Its board of directors was composed of representatives of the member organizations. Each member had the right to an accounting of its pro rata share of the investment funds and could withdraw from participation upon thirty days notice. The organization did not make its services available to anyone other than the exempt organizations controlling it. Most of the operating expenses of the organization, including the costs of the services of the investment counselors and the custodian banks, were paid for by grants from independent charitable organizations. The member organizations paid only a nominal fee (less than fifteen percent of the total costs of operation) for the services performed. The Service reasoned that the organization's investment activity was an essential function of the exempt universities, and that the organization performed its activity in a charitable manner by charging its charitable members a fee substantially below cost. The Service distinguished the organization from the one described in Rev. Rul. 69-528 in that the latter organization was primarily engaged in carrying on an investment management business for charitable organizations on a fee basis free from control of the participants.

Rev. Rul. 72-369, 1972-2 C.B. 245, held not exempt under section 501(c)(3) of the Code an organization formed to provide managerial and consulting services at cost to unrelated 501(c)(3) organizations. The Service reasoned that providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit, and providing such services at cost solely to exempt organizations is not sufficient to characterize the activity as charitable.

In Better Business Bureau v. United States, 316 U.S. 279 (1945), the Supreme Court considered the meaning of "exclusively" in the 501(c)(3) predecessor provision. The Court held that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption.

In Leon A. Beechly Fund v. Commissioner, 35 T.C. 490, 518 (1960), the court held that a trust was not operated exclusively for charitable purposes where it entered into a transaction with the primary objective to benefit a for-profit corporation largely owned by the trust's creator rather than to benefit charities, even though the trust emerged from the transaction without financial loss.

In Stevens Bros. Foundation, Inc. v. Commissioner, 324 F.2d 633 (8th Cir. 1963), the court upheld revocation of an organization's charitable exemption where the organization's funds were used to make loans to for-profit organizations controlled by the same persons, even though the loans were ultimately profitable.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd by unpublished opinion, 647 F.2d 170 (9th Cir. 1981), a nonprofit organization paid a for-profit organization for licenses to conduct "est" programs involving training, seminars, and lectures in intrapersonal awareness and communication. The court ruled that the nonprofit's activities served the commercial purposes of the for-profit corporations and thus the nonprofit was not operated exclusively for exempt purposes under section 501(c)(3) of the Code. Even though the nonprofit was not formally controlled by the same individuals as the for-profits, the for-profits exerted considerable control over the nonprofit's activities through the licensing agreements. The nonprofit's only function was to sell to the public ideas with materials and trainers supplied and controlled by the for-profits. Regardless of whether the payments from the nonprofit to the for-profits were excessive, the for-profits benefitted substantially from the nonprofit's operation. The nonprofit was simply the instrument to subsidize the for-profits and not vice-versa and had no life independent of the for-profits.

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), a nonprofit organization's regularly scheduled bingo games were held on the premises of a for-profit business which sold food and beverages, the games were conducted by the owners of the for-profit, and the directors of the for-profit controlled the nonprofit's board. Under these circumstances, the court held

that the nonprofit had a substantial non-exempt purpose to enhance the profits of the for-profit.

In Church of Ethereal Joy v. Commissioner, 83 T.C. 20, 23 (1984), a nonprofit organization was controlled by a small, self-perpetuating group who could, without challenge, dictate its program and operations, prepare its budget, and spend its funds, and continue to do so indefinitely. The court noted that while control by such a small group may not necessarily disqualify the organization for exemption, such control provides an obvious opportunity for abuse of the claimed tax-exempt status.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), the court upheld denial of 501(c)(3) status to a church operated for the substantial non-exempt purpose of providing a market for the services of a for-profit advertising agency owned and controlled by its two ministers. The church's primary activity was preparing and mailing religious sermons and messages which included requests for money. The for-profit did the printing and mailing. The two organizations shared office space. The church provided the primary market for the for-profit's business, with two-thirds of the time of the for-profit's employees devoted to work for the church. The majority of the church's income was paid to the for-profit. The court noted that the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable, but instead whether the entire enterprise is carried on in such a manner that the for-profit benefits substantially from the operation of the nonprofit.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 (1989), the court upheld revocation of 501(c)(3) exemption of a nonprofit organization that conducted continuing medical education tours abroad. The nonprofit had a substantial non-exempt purpose to benefit a for-profit travel agency which the nonprofit used exclusively to arrange tours for its seminars. The nonprofit spent 90% of its revenue on brochures for tours arranged by the for-profit and did not solicit competitive bids from any other travel agency. The nonprofit was formed by the owner of the for-profit to obtain customers for his tour business, he controlled the nonprofit, and he exercised that control for the benefit of the for-profit. The court noted that when a for-profit benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes under section 501(c)(3), even if it furthers other exempt purposes.

Even if the trusts served exclusively charitable beneficiaries, you would not be described in section 501(c)(3) of the Code unless the beneficiaries controlled you and your services were provided substantially below cost, under the reasoning of the Rev. Ruls. 69-528, 71-529, and 72-369. However, you are not controlled by exempt organizations, and your services are not provided substantially below cost.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[REDACTED]
[REDACTED]
Chief, Exempt Organizations
Technical Branch 5

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